

**Improvements Are Needed to Ensure  
Innocent Spouse Claims Are Accurately and  
Timely Processed**

**June 2003**

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DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

June 27, 2003

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

*Gordon C. Milbourn III*

FROM: Gordon C. Milbourn III  
Assistant Inspector General for Audit (Small Business and  
Corporate Programs)

SUBJECT: Final Audit Report – Improvements Are Needed to Ensure  
Innocent Spouse Claims Are Accurately and Timely Processed  
(Audit # 200240042)

This report presents the results of our review to determine whether innocent spouse claims were worked accurately and timely in the Innocent Spouse “First Read”<sup>1</sup> area. This review is part of our discretionary audit coverage of the Compliance area within the IRS’ Wage and Investment (W&I) Division and is included in our Fiscal Year 2003 Annual Audit Plan.

The Congress passed the IRS Restructuring and Reform Act of 1998 (RRA 98)<sup>2</sup> in part to address concerns about protecting the innocent spouse who signed a joint tax return without knowledge of specific items on the tax return and became personally liable for the errors of his or her spouse. In anticipation of the RRA 98, the IRS established the Cincinnati Centralized Innocent Spouse Operation (the Centralized Site) in March 1998. The goal was to centralize claim processing to ensure that the rights of spouses are protected and that claims are processed accurately, timely, and consistently.

Examiners accurately made determinations as to whether taxpayers met basic qualifications necessary to file a claim. However, we did identify concerns that affect the accuracy and timeliness of innocent spouse claim processing. Specifically, freezes<sup>3</sup> necessary to halt IRS collection actions are not effective in stopping a

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<sup>1</sup> The “First Read” process is the initial screening of innocent spouse claims received by the Internal Revenue Service (IRS) to determine whether a claim meets basic filing qualifications.

<sup>2</sup> IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

<sup>3</sup> A freeze prevents certain activity from being conducted on the taxpayer account until the freeze is reversed.

continuous levy<sup>4</sup> in place prior to the IRS' receipt of a claim. The IRS has been aware of this problem since 1998; however, no action has been taken to develop a process to ensure these levies are halted. We identified 25 taxpayers that were levied on subsequent to filing a claim; as a result, the IRS received over \$25,000. In addition, the freeze necessary to halt levy action is not always placed on taxpayer accounts as required by law. From January through September 2002, a total of 37,167 claims were filed by 19,006 taxpayers. There were 30,592 freezes placed on taxpayer accounts. However, 22,691 (74 percent) of these freezes were not immediately placed on the taxpayer accounts, as required. In addition, for 610 claims, the required freeze was never placed on the taxpayer accounts. For the remaining 7,190 claims, a freeze was not required.<sup>5</sup>

For the accounts with a freeze, we found some freezes were not reversed when the claim did not meet basic qualifications. When the freeze is not removed, the IRS is unable to re-initiate actions to collect the taxes owed. As of September 2002, we identified 32 claims for which the freeze was not removed from the taxpayer accounts. These taxpayers owe approximately \$219,000.

Management information on the processing of claims in the "First Read" area is captured on the Innocent Spouse Tracking System (ISTS). The Integrated Case Processing (ICP) program<sup>6</sup> transfers information to the ISTS that is used to generate management reports detailing program accomplishments; however, claim origination was not consistently captured because the ICP program was not transferring the origin field to the ISTS. The accuracy of claim origination is essential to the IRS' ability to identify processing delays and to educate taxpayers on where to send claims.

Finally, the IRS had not established timeliness benchmarks for those claims that originated in the field, and the claims that originated at the Centralized Site were not always processed within established time periods. For the 24,702 claims originating at the Centralized Site, 11,128 (45 percent) were not processed within the IRS' established time periods. For the 12,465 claims originating in the field, 9,512 (76 percent) were not processed within the IRS' established time periods for the Centralized Site. Overall, 20,640 claims were not processed timely, affecting 10,732 taxpayers. The delays in processing were caused, in part, by the field not transferring the claims to the Centralized Site timely (up to 224 days) and by a delay in assigning the claims to examiners (up to 14 days). Individuals who have not been granted relief within 6 months of receipt of a claim can petition the Tax Court for relief;<sup>7</sup> we found that 383 claims met this criterion.

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<sup>4</sup> A continuous levy involves funds taken from a taxpayer's wages for a set amount and time period to satisfy a tax debt.

<sup>5</sup> Because duplicate freezes were placed on taxpayer accounts, the 30,592 freezes on accounts and the 7,800 (7,190 + 610) freezes not placed on accounts will exceed the number of claims (37,167) filed by taxpayers.

<sup>6</sup> The ICP program was developed to assist examiners in consistently applying tax laws by providing step-by-step questions that help the examiner determine whether the claim qualifies the taxpayer for innocent spouse relief.

<sup>7</sup> Internal Revenue Code Section 6015(e)(1)(A) (1998).

To ensure taxpayer rights are protected and taxpayer burden is reduced, we recommended the Commissioner, W&I Division, develop a process to ensure collection actions are halted, ensure freezes are placed or removed from taxpayer accounts, and develop internal guidelines to address claims where a freeze is not required. We also recommended that he ensure claim origination information is accurate, revise the Innocent Spouse form to include a reminder to send claims directly to the Centralized Site, develop a timeliness benchmark for claims received in the field, and develop a process to enable management to monitor timeliness of claims processing.

Management's Response: The IRS stated that it has worked vigorously to implement key provisions of the RRA 98, including those that affect innocent spouses. IRS management believes our report does not adequately stress the dramatic improvements in this program. The IRS cited that during 2002, it improved the timeliness of claims processing from 43 percent to 97 percent and the timeliness of freeze code processing from 32 percent to 80 percent. In addition, although the IRS agrees there were 1,200 instances where the freeze or the removal of a freeze was not posted due to an unpostable condition, the IRS stated that it corrected these accounts prior to our audit.

The IRS agreed with six of our seven recommendations and is taking corrective action. The IRS did not agree that a timeliness benchmark for claims received in the field is warranted. Other actions the IRS is taking should significantly reduce the number of claims received in the field.

Office of Audit Comment: We agree with management's assertion that the IRS has worked vigorously to implement key innocent spouse provisions contained in the RRA 98. Management provided performance information as background in their response to our report relating to improvements in the timeliness of claim and freeze code processing. However, we cannot attest to the improvement cited by management. Our review of claims received during January through September 2002 identified that for 74 percent of the claims reviewed, the required freeze was not timely placed on the taxpayer accounts. Furthermore, for those claims originating at the Centralized Site and for which management has established timeliness claim processing benchmarks, 45 percent were not processed within time periods established by IRS management.

In addition, management asserted that we identified over 19,000 taxpayers that were subject to a levy. We did not identify that over 19,000 taxpayers were subject to a levy; however, as detailed in our report, because of control weaknesses, the IRS cannot have reasonable assurance that taxpayers who file innocent spouse claims will have their rights protected. Management's implementation of our recommendations will strengthen these controls.

Lastly, management indicated in their response that the 1,200 reported unpostable conditions (condition that prevents freezes from being added to or removed from a taxpayer's account) were corrected prior to our review. We take exception to this statement based on the fact that IRS management was not receiving copies of the reports that identify these conditions and that these unpostable conditions occurred throughout 2002 both prior to and subsequent to the beginning of our audit in July 2002.

We commend IRS management for their agreement to implement six of our seven recommendations that will help the IRS ensure that taxpayer rights are protected and taxpayer burden is reduced. For the recommendation where management has not agreed to take corrective action, we agree that other actions management plans to take may reduce the volume of claims that will be sent to the field. However, until management can ensure that the majority of the claims are received at the Centralized Site, we still believe the establishment of timeliness benchmarks for claims received in the field is warranted. Nevertheless, we do not intend to elevate our disagreement to the Department of the Treasury for resolution. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

**Improvements Are Needed to Ensure Innocent Spouse Claims  
Are Accurately and Timely Processed**

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## Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed

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### **Background**

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In 1998, the Congress passed the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)<sup>1</sup> in part to address the concerns the Congress had regarding IRS collection actions (including levy and seizure) that may be taken against a spouse who, without knowledge of items on the income tax return, signed a joint tax return and became personally liable for the errors of the other spouse. Married taxpayers who file joint income tax returns are jointly and individually responsible for the tax and any interest and penalty due on the joint tax return. This liability continues even if they later divorce.

In anticipation of the RRA 98, the Cincinnati Centralized Innocent Spouse Operation (referred to as the Centralized Site), located in Florence, Kentucky, was established in March 1998. The goal was to centralize claim processing to ensure that the rights of spouses are protected and that claims are processed accurately, timely, and consistently. Taxpayers can send claims either directly to the Centralized Site or to an IRS field function.<sup>2</sup> It is then the responsibility of the field functions to send the claims to the Centralized Site on behalf of the taxpayers. Since the enactment of the RRA 98, a total of 107,723 taxpayers have filed 204,673 claims.

Claims are received either from IRS field functions or directly from the taxpayer at the Centralized Site on a daily basis. Upon receipt of a claim at the Centralized Site, a clerk stamps the received date on the claim. The claims are then placed in bundles and assigned to examiners in the “First Read”<sup>3</sup> area. After being assigned to an examiner, the claims are screened to determine if basic qualifications needed to file a claim have been met. Based on the

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<sup>1</sup> IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

<sup>2</sup> We determined field/field functions/field offices to be any IRS function/office (e.g., an IRS campus) outside the Centralized Site.

<sup>3</sup> The “First Read” process is the initial screening of innocent spouse claims received by the IRS to determine whether a claim meets basic filing qualifications.

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examiners' review, the claims are then classified into two categories:

- *Qualified* – met basic qualifications which include, but are not limited to: (1) filed a joint tax return, (2) properly signed the claim form, (3) made a claim for a tax year in which a tax return was filed, and (4) provided a valid Social Security Number.
- *Nonqualified* – did not meet one of the basic qualifications.

If the examiner concludes that the claim is qualified, the claim moves to the next level in the determination process and an assessment is performed to determine whether relief should be provided. If the examiner concludes that the claim is nonqualified, the claim is closed and the taxpayer is notified.

This audit was conducted at the Centralized Site in Florence, Kentucky, from July 2002 to January 2003. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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### **Determinations Were Accurately Made As to Whether Taxpayers Met Basic Qualifications**

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If a taxpayer has questions as to whether he or she may qualify for innocent spouse relief after reviewing Innocent Spouse guidelines contained in IRS publications, the IRS encourages these taxpayers to file a claim with the IRS. The IRS will then determine for the taxpayer whether he or she meets the requirements needed to file a claim. Our review of a random sample of 32 claims received from January to May 2002 identified that examiners accurately determined whether the claims met basic qualifications.

To assist examiners in consistently interpreting innocent spouse tax laws, the IRS developed the Integrated Case Processing (ICP) program. Implementation of the ICP program began in January 2001, with the automated case processing capabilities becoming fully operational as of June 2002. The ICP program provides examiners with step-by-step questions. Based on the answers provided by the examiner, the ICP program focuses the examiner on the

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### **Innocent Spouse Claims Were Not Always Accurately Processed**

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proper decision as to whether the claim qualifies the taxpayer for innocent spouse relief.

The ICP program has improved the IRS' ability to process claims more consistently, therefore lessening the burden to the taxpayer. In addition, the IRS has issued guidelines to assist the examiner in reaching the basic determinations. These guidelines include specific instructions to the examiner for the suggested actions encountered while processing a claim.

Our review identified that innocent spouse claims were not always processed accurately. Specifically, we found that:

- The IRS did not always ensure collection actions were immediately halted.
- The IRS did not always ensure freezes were removed from taxpayer accounts.
- Management information systems did not always reflect the origination of the claim.

#### **The IRS did not always ensure collection actions were immediately halted**

The Internal Revenue Code (I.R.C.)<sup>4</sup> contains provisions that protect the rights of taxpayers who file innocent spouse claims by restricting the collection activity (actions the IRS takes to collect taxes owed) immediately upon IRS receipt of a claim. Specifically, no levy<sup>5</sup> or proceeding in court shall be made against any individual filing a claim until the determination period has expired or a decision has been made by the Tax Court.

To comply with the tax law, internal guidelines require a freeze to be placed on the taxpayer's account immediately upon determining whether the claim is processable. The freeze places the taxpayer's account into a condition that prevents certain collection actions from being conducted against the taxpayer; it must be removed for collection action to continue. The freeze is required to be placed on

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<sup>4</sup> I.R.C. Section (§) 6015(e)(1)(B)(i) (1998) contains provisions that restrict IRS collection activity immediately upon IRS receipt of a claim.

<sup>5</sup> A levy is a legal seizure of property to satisfy a tax debt.

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each tax year for which the taxpayer is requesting innocent spouse relief.

### ***Freeze process does not halt levies established prior to the IRS' receipt of a claim***

Since 1998, IRS management has known that existing freeze procedures were not effective in halting prohibited collection actions on certain accounts. The freeze currently used to halt collection actions is not effective in stopping levy action for "continuous levies"<sup>6</sup> that were in place prior to the taxpayer's filing of a claim. We identified that 25 taxpayers were levied subsequent to filing a claim; as a result, the IRS received over \$25,000. This problem continues to exist because no procedures have been implemented to ensure taxpayers are protected against these levy actions taken subsequent to the filing of a claim.

### ***Freezes to halt collection action were not input as required***

Freezes to taxpayer accounts were not input as required. IRS guidelines require freezes to be immediately placed on a taxpayer's account when a claim is received. Our review of 37,167 claims filed by 19,006 taxpayers from January through September 2002 identified 30,592 freezes placed on taxpayer accounts. In addition, 7,800 freezes were never placed on taxpayer accounts. For 610 of these claims, the freeze was required on the taxpayer accounts. For the remaining 7,190 claims, a freeze was not required.<sup>7</sup>

*Freezes were not always input immediately upon the IRS' receipt of a claim.* For the 30,592 freezes on taxpayer accounts, we found that 22,691 (74 percent) were not input immediately, as required by the I.R.C.<sup>8</sup> See the following chart.

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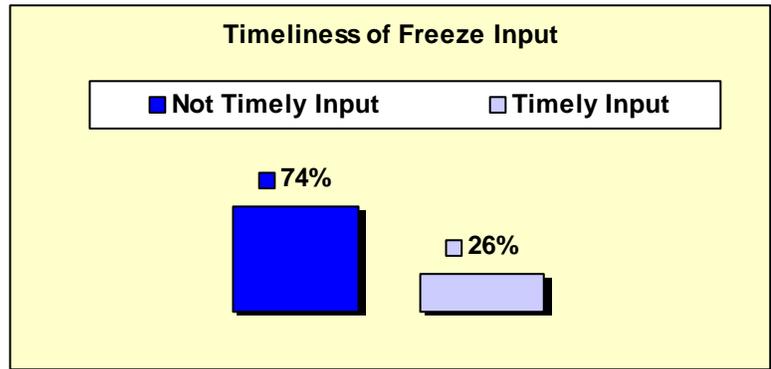
<sup>6</sup> A continuous levy involves funds taken from a taxpayer's wages for a set amount and time period to satisfy a tax debt.

<sup>7</sup> Because duplicate freezes were placed on taxpayer accounts, the 30,592 freezes on accounts and the 7,800 (7,190 + 610) freezes not placed on accounts will exceed the number of claims (37,167) filed by taxpayers.

<sup>8</sup> I.R.C. § 6015(e)(1)(B)(i) contains provisions that restrict IRS collection activity immediately upon IRS receipt of a claim.

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*Source: Analysis of Integrated Data Retrieval System (IDRS)<sup>9</sup> data and data captured on the Innocent Spouse Tracking System (ISTS) for the period January 1 to September 30, 2002.*

For the 74 percent of freezes that were not input timely, we found that the delays in inputting the freeze ranged from 1 to 260 days, with the average being 21 days.<sup>10</sup>

A number of delays affected the IRS' ability to meet the requirement to immediately halt collection action. These delays include the field transferring claims to the Centralized Site, the mailroom delivering claims to the Centralized Site, receipt at the Centralized Site until assignment to an examiner, and input of the freeze until posting to a taxpayer's account. However, a process has not been developed to proactively assist taxpayers that may be affected as a result of the delays.

*Freezes were not always input upon the IRS' receipt of a claim.* We identified that 7,800 freezes were never placed on taxpayers' accounts; however, our review of these accounts found that the majority of the accounts did not require a freeze. Reasons for not requiring a freeze include issues such as no taxes were due, no tax return was filed, or the tax return filed was not a joint tax return. We did determine, however, that 610 (8 percent) of these 7,800 accounts required a freeze.

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<sup>9</sup> IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

<sup>10</sup> To account for delays resulting from IRS computer systems, we allowed 18 days from the receipt of the claim until the freeze is placed on the taxpayer's account.

## Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed

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Management indicated that internal guidelines did not specifically address situations in which a freeze was not required, which resulted in inconsistencies in the manner in which freezes were placed on accounts. In addition, there are instances where the freeze was input, yet it did not end up on the taxpayer's account. The IRS refers to this as an "unpostable condition." A report is generated that details those taxpayer accounts for which the input of the freeze went unposted.<sup>11</sup> However, management was not receiving or requesting the reports to address these instances. Management indicated that the process to obtain these reports is time-consuming and cumbersome. In Calendar Year 2002, there were approximately 1,200 instances where the freeze or the removal of a freeze was unpostable.

### *Affect on taxpayers when freezes are not input as required*

Overall, 19,006 taxpayers' rights were at risk for claims filed from January through September 2002. Our analysis of taxpayer accounts associated with the 37,167 claims received during this time identified 25 taxpayers as having been levied by the IRS subsequent to the taxpayer's filing of a claim. The amount received by the IRS from these levies totaled over \$25,000.

In addition, because of control weaknesses identified, the IRS cannot have reasonable assurance that taxpayers who file innocent spouse claims will have their rights protected. There is a potential that approximately 107,723 taxpayers who submitted claims prior to and during the period we analyzed may have been subject to inaccurate processing of their claims.

### **The IRS did not always ensure freezes were removed from taxpayer accounts**

The IRS does not have a process to ensure that examiners remove the freeze that halts collection action from a taxpayer's account when it is determined that the taxpayer's

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<sup>11</sup> For the 7,800 accounts, we were unable to determine those for which an error was made in placing the freeze on the taxpayer's account. The IRS did not have this information in a format that permitted data analysis.

## **Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed**

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claim did not meet basic requirements. Removing the freeze allows the IRS to re-initiate collection actions as needed in an attempt to collect the taxes owed. As of September 2002, we identified 9,042 claims that had been closed as not meeting basic requirements. For 32 of these claims, the freeze was not removed from the taxpayer accounts to re-initiate collection actions. Taxes owed by these individuals total approximately \$219,000.

Innocent Spouse Program management indicated that plans are in place to include controls to ensure freezes are removed as part of a revision to the ICP program. However, no target date has been established for implementation, and no interim procedures have been developed to date.

The IRS could increase revenue in the amount of \$219,000 by ensuring freezes are removed from the 32 accounts we identified during the review that were closed as nonqualified but still had a freeze present.

### **Management information systems did not always reflect the origination of the claims**

Management information relative to the processing of claims in the “First Read” area is captured on the ISTS. The ICP program transfers information to the ISTS, and these data are used to generate management reports detailing program accomplishments.

In our review of data contained on the ISTS, we identified that claim origination was not consistently captured. The inconsistency arose from the fact that information included in the claim origin field on the ICP program was not transferring to the ISTS. In addition, examiners are required to input the origin of the claim into the ICP program; however, regardless of what was input, the origin field defaulted to the claim as being received at the Centralized Site. Management was not aware of the fact that the claim origin information was not being updated to the ISTS. The accuracy of claim origination is essential to the IRS’ ability to identify processing delays as well as its ability to educate taxpayers on where to send claims.

## **Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed**

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### **Recommendations**

To ensure claims are processed accurately, the Commissioner, Wage and Investment (W&I) Division, should:

1. Develop a process to ensure collection actions are halted and freezes are removed from accounts as required. Incorporated in this process should be procedures to obtain and use the unpostable reports and procedures to ensure collection actions on continuous levies are halted.

Management's Response: The IRS stated that the Wage and Investment Division's Compliance function implemented several actions to ensure collection actions are halted and freezes are removed from accounts as required. They stated that in the first quarter of Fiscal Year (FY) 2003, they issued procedures for processing claims when a levy is involved; revised Internal Revenue Manual (IRM) 25.15 to inform employees about freeze requirements; and required managers to retrieve and resolve weekly the electronic unpostable listing. In the second quarter of FY 2003, they initiated a Request for Information Services placeholder for systemic changes to the Automated Collection System to prevent levy action from occurring on a petitioning spouse; and issued a joint memorandum with Field Assistance to ensure new claims received in the field are expeditiously forwarded to the Centralized Site. Finally, management stated that Phase IV of the ICP program will systemically remove freezes as cases are closed.

2. Ensure freezes are in place or removed for the claims we identified during our review and, as appropriate, for those claims received prior to and subsequent to our data analysis,<sup>12</sup> until a formal process is developed (see Recommendation #1) to ensure taxpayer rights and the Federal Government's interest in taxes owed is protected.

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<sup>12</sup> Data analysis included claims received from January through September 2002.

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Management's Response: The IRS stated they will review the cases to ensure the freezes are in place or removed as appropriate.

3. Develop internal guidelines to specifically address those claims where a freeze is not required.

Management's Response: The IRS stated they revised IRM 25.15.2.4.2 to specifically list when a Transaction Code 971 (which generates the collection freeze) is not applicable.

4. Ensure claim origination information is accurately transferred from the ICP program to the ISTS and that the claim origination field requires a mandatory entry, thereby eliminating default to the Centralized Site as the claim origination.

Management's Response: The IRS stated that programmers for the ICP program and the ISTS, along with the Innocent Spouse analyst, corrected programs to accurately transfer claim origin information from the ICP program to the ISTS.

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### Innocent Spouse Claims Were Not Always Timely Processed

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The IRS has not been successful in processing innocent spouse claims within time periods established by both the I.R.C. and the Innocent Spouse Program Office.

Specifically, we found that:

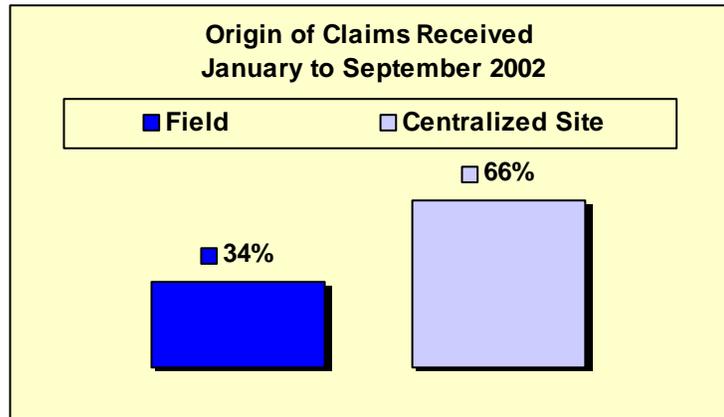
- Timeliness benchmarks had not been established for claims that originated in the field.
- Claims originating at the Centralized Site were not always processed within established time periods.
- The I.R.C. allows taxpayers to petition the Tax Court.

#### **Timeliness benchmarks had not been established for claims that originated in the field**

The IRS had not established timeliness benchmarks for those claims that originated in the field despite the fact that 34 percent of the claims received during the period we reviewed originated there. The following chart illustrates the origin of the 37,167 claims filed from January through September 2002, with 12,465 (34 percent) originating in the field and 24,702 (66 percent) originating at the Centralized Site.

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Source: Analysis of IDRS and data captured on the ISTS for the period January 1 to September 30, 2002. See claim origination data capturing limitations on page 7.

For the 12,465 claims originating in the field, 11,889 claims (95 percent) were *not* received by the Centralized Site within 5 calendar days of the field's receipt of the claim.<sup>13</sup> The claims were received in the Centralized Site from 6 to 224 days after receipt in the field, with the average being 27 days.

We also identified that 9,512 (76 percent) of claims originating from the field were not processed within the IRS' established time periods for the Centralized Site.<sup>14</sup> For those 9,512 claims, the range of days in excess of the IRS' goal was 1 to 253 days, with the average being 36 days.

The IRS encourages taxpayers to submit claims directly to the Centralized Site in its instructions for the Request for Innocent Spouse Relief (Form 8857). However, there is no reminder placed directly onto the Form 8857 alerting the taxpayer to mail the claim directly to the Centralized Site if the taxpayer is not working with an IRS employee in Examination, Appeals, or Collection. Placing a reminder on the form may reduce the number of claims sent to various IRS field functions, thereby reducing the delays for the

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<sup>13</sup> We determined 5 calendar days to be reasonable for the field to transfer a claim to the Centralized Site.

<sup>14</sup> Using the timeliness benchmark established for the Centralized Site, we calculated the number of days from the receipt of claims in the IRS to the claim being closed from the "First Read" area.

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taxpayer. Also, there is a delay (up to 14 days) in assigning the claims to the examiners once the claim is received in the Centralized Site.

### **Claims originating at the Centralized Site were not always processed within established time periods**

The benchmarks established for those claims that originate at the Centralized Site are:

- *Qualified claims* – complete the “First Read” determination process within 75 days from the receipt of the claim.
- *Nonqualified claims* – complete the “First Read” determination process within 15 days from the receipt of the claim.

Our review of the 24,702 claims originating at the Centralized Site identified that 11,128 (45 percent) were not completed within the IRS’ established time periods. For the 4,655 untimely, qualified claims, the IRS completed the claims within 76 to 231 days, with the average being 98 days. For the 6,234 untimely, nonqualified claims, the IRS completed the claims within 16 to 268 days, with the average being 33 days. The remaining 239 claims were still in process at the time we completed our audit; however, the processing time period has already exceeded the 75 days from the time the claim was received.

### **The I.R.C. allows taxpayers to petition the Tax Court**

The I.R.C.<sup>15</sup> contains provisions that are designed to reduce the burden on taxpayers whose claims may not be timely processed. The I.R.C. allows these individuals to petition the Tax Court if a final determination letter has not been issued within 6 months from the date the claim is received by the IRS. The Tax Court then has the jurisdiction to determine the appropriate relief for the individual filing the claim.

Overall, 10,732 taxpayers filed claims that were not processed timely. There were 383 (1 percent of the 37,167)

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<sup>15</sup> I.R.C. § 6015(e)(1)(A) (1998).

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claims that were processed in excess of the 6 months, after which the taxpayer then had a basis to go to the Tax Court for a determination.

### ***Effect on taxpayers when claims are not processed timely***

A process has not been developed to ensure claims are timely worked. Specifically, management is currently unable to monitor the timeliness of claim processing from the time the IRS receives a claim until the determination process is completed. As a result of processing delays, taxpayers could be burdened by having to request the Tax Court to make a determination, as well as not receiving the prompt action they may expect on their claim processing.

### **Recommendations**

To ensure claims are processed timely, the Commissioner, W&I Division, should:

5. Revise Form 8857 to include a reminder to send claims directly to the Centralized Site for those taxpayers who are not working with an IRS employee in Examination, Appeals, or Collection or who have not received a Notice of Deficiency.

Management's Response: The IRS responded that they have established a P.O. Box number where all innocent spouse claims should be mailed, and are requesting changes to Form 8857 to include the P.O. Box number and instructions advising the taxpayer to mail the completed form to that address. They indicated they issued a memorandum on October 2, 2002, advising field employees to expedite the routing of Forms 8857 to the Centralized Site.

6. Develop a timeliness benchmark for those claims received in the field.

Management's Response: The IRS stated they do not agree that a timeliness benchmark for claims received in the field is warranted. They believe that other actions they are taking should significantly decrease the number of claims received in the field.

## **Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed**

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Office of Audit Comment: We agree that other actions IRS management plans to take may reduce the volume of claims that will be sent to the field. However, until management can ensure that the majority of the claims are received at the Centralized Site, we still believe the establishment of timeliness benchmarks for claims received in the field is warranted. Please see the report transmittal for additional Office of Audit comments.

7. Develop a process to enable management to monitor claims from the IRS' receipt until a determination is completed.

Management's Response: The IRS indicated they will design new management inventory reports on the ICP program that will readily identify claims that stay in a particular stage longer than the recommended time.

## Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed

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### Appendix I

#### Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether innocent spouse claims were worked accurately and timely in the Innocent Spouse “First Read”<sup>1</sup> area. Specifically, we:

- I. Obtained and reviewed Internal Revenue Service (IRS) guidelines, the Internal Revenue Code, the reference guide for the Innocent Spouse Tracking System (ISTS), the Job Aid for the Integrated Case Processing program, and other internal guidelines and memoranda.
  - A. Identified the processes followed when processing innocent spouse claims.
  - B. Identified the requirements for spouses who request relief from liability by filing claims.
  - C. Identified the stages and processes of claims being filed in the “First Read” area of the Centralized Site.
  - D. Held discussions with representatives from the Centralized Site and IRS management to identify controls in place for processing innocent spouse claims.
- II. Determined if controls were in place to ensure that the rights of individuals that file innocent spouse claims were protected.
  - A. Obtained a computer extract from the ISTS for January 1 to September 30, 2002.
  - B. Matched the Taxpayer Identification Numbers from the ISTS extract to entity and account history from IRS data that was obtained through the Treasury Inspector General for Tax Administration (TIGTA) Data Warehouse.
  - C. Analyzed taxpayer accounts associated with 37,167 claims received from January 1 to September 30, 2002. For these accounts, we retrieved data from the TIGTA’s Data Warehouse to determine whether prohibited collection activity had ceased on the accounts of individuals filing innocent spouse claims. To accomplish this analysis, we specifically:
    1. Matched the ISTS extract data with the entity and account history data to ensure our analysis was based on the ISTS data and within the time periods in the ISTS.
    2. Assessed the number of accounts where a Transaction Code (TC) 971 (causes a freeze to be input to a taxpayer’s account) was posted and not posted.

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<sup>1</sup> The “First Read” process is the initial screening of innocent spouse claims received by the IRS to determine whether a claim meets basic filing qualifications.

**Improvements Are Needed to Ensure Innocent Spouse Claims  
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3. Assessed from the account data where the TC 971 was input timely and where the TC 971 was not input timely.
  4. Assessed from the data where the TC 972 (causes a freeze to be removed from a taxpayer's account) was not input on accounts where claims were closed as nonqualified.
  5. Assessed the account data to determine the number of levies and levy payments posted to the accounts of individuals after they had filed innocent spouse claims.
- III. Determined if controls were in place to ensure that innocent spouse claims were received from the field in the Centralized Site timely.
- A. Obtained a computer extract from the ISTS for January 1 to September 30, 2002.
  - B. Assessed from the extract the number of claims received from the field and calculated the number of days from receipt of claims in the field to receipt of claims in the Centralized Site.
  - C. Calculated the processing time of claims forwarded from the field to the Centralized Site.
  - D. Identified from the extract the claims received in the Centralized Site and calculated the processing time of these claims through the "First Read" area of the Centralized Site.
- IV. Interviewed management to identify factors that contributed to the inadequate IRS controls to prevent collection action and process innocent spouse claims timely.
- V. Determined the number of innocent spouses whose rights were violated by continued collection activity, the number of innocent spouses burdened by the untimely input of the TC 971, and the number of innocent spouses burdened by the untimely processing of innocent spouse claims. We also determined the potential loss of revenue to the IRS as a result of a TC 972 not being posted to accounts where nonqualified claims were closed.

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**Appendix II**

**Major Contributors to This Report**

Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs)

Kerry Kilpatrick, Director

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**Appendix III**

**Report Distribution List**

Commissioner N:C

Deputy Commissioner for Services and Enforcement N:DC

Deputy Commissioner, Wage and Investment Division W

Director, Compliance W:CP

Director, Reporting and Compliance W:CP:RC

Innocent Spouse Project Manager W:ISP

Chief Counsel CC

National Taxpayer Advocate TA

Director, Legislative Affairs CL:LA

Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O

Office of Management Controls N:CFO:AR:M

Audit Liaison:

Program/Process Assistant Coordinator, Wage and Investment Division W:HR

## Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed

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### Appendix IV

#### Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

##### Type and Value of Outcome Measure:

- Taxpayer Rights – Potential; 107,723 taxpayers who submitted claims prior to and during the period we analyzed may have been subject to inaccurate processing of their claims (see page 3).

##### Methodology Used to Measure the Reported Benefit:

We determined the number of taxpayers potentially affected to be any taxpayer filing a claim from the enactment of the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)<sup>1</sup> to September 30, 2002. Because of control weaknesses identified, the IRS cannot have reasonable assurance that taxpayers who file innocent spouse claims will have their rights protected. We calculated the number of taxpayers by determining the number of claims received by the IRS from the enactment of the RRA 98 to September 30, 2002, and then used the formula established by the IRS to determine the number of taxpayers affected.  
(156,206 + 48,467 = 204,673/1.9 = 107,723)<sup>2</sup>

##### Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$219,000 for 32 taxpayer accounts where the freeze was not removed from the taxpayer's account to re-initiate collection actions (see page 3).

##### Methodology Used to Measure the Reported Benefit:

We determined the number of closed nonqualified claims from the Innocent Spouse Tracking System (ISTS). We matched the data from the ISTS to data from the Integrated Data Retrieval System (IDRS)<sup>3</sup> to determine the number of accounts that had a freeze on the account that had

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<sup>1</sup> IRS Restructuring and Reform Act of 1998 (RRA 98) Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

<sup>2</sup> From the enactment of the RRA 98 to September 30, 2001, there were 156,206 claims received by the IRS. From October 1, 2001, to September 30, 2002, there were 48,467 claims received by the IRS. These 2 numbers were added (156,206 + 48,467) and then divided by 1.9 tax modules (determined by the IRS as being the average number of tax modules per claim) to determine the number of taxpayers who filed claims for the period from the enactment of the RRA 98 to September 30, 2002.

<sup>3</sup> IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

## **Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed**

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not been removed upon closure of the claim. From the data we extracted from the IDRS, we calculated the total of all the account balances shown on the IDRS.

### Type and Value of Outcome Measure:

- Taxpayer Burden – Actual; 10,732 taxpayers filed claims that were not processed timely (see page 9).

### Methodology Used to Measure the Reported Benefit:

We determined the number of actual taxpayers burdened by calculating the number of claims that were not timely processed for the period January 1 to September 30, 2002. Because one taxpayer may file numerous claims, we then analyzed the Social Security Numbers to ensure none were counted more than once to determine the number of taxpayers who filed claims for the period January 1 through September 30, 2002.

**Improvements Are Needed to Ensure Innocent Spouse Claims  
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Appendix V

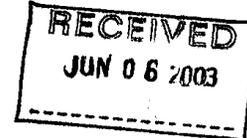
**Management's Response to the Draft Report**



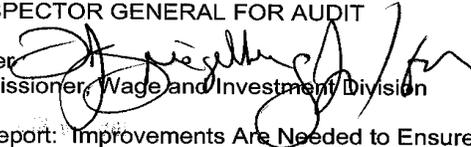
COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

JUN 06 2003



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: John C. Duder   
Acting Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report: Improvements Are Needed to Ensure  
Innocent Spouse Claims Are Accurately and Timely  
Processed (Audit #200240042)

Since enactment of the Restructuring and Reform Act of 1998 (RRA98), the IRS has worked vigorously to implement key taxpayer rights provisions including those that affect innocent spouses. While acknowledging this effort, your report does not adequately stress the dramatic improvements we have made in this program.

Our drive to quickly implement RRA98 mandates led us to establish the Cincinnati Centralized Innocent Spouse Operation (CCISO) in March 1998. The CCISO was designed to centralize claims processing, ensure consistency, and improve response times. Since that time, we have dramatically improved our handling of innocent spouse matters.

Consider these facts: With the June 2002 implementation of our Integrated Case Processing tool to process taxpayer claims, our performance jumped dramatically. During 2002, we improved the timeliness of our claims processing from 43 percent to 97 percent and the timeliness of our freeze codes processing from 32 percent to 80 percent. Since the inception of CCISO, 107,723 taxpayers have filed over 200,000 claims.

Although your report suggests otherwise, your findings show we are extremely successful at protecting taxpayers from collection activity while they have a claim pending for innocent spouse relief. Your review identified 25 out of over 19,000 taxpayers who were subject to a levy, but only 3 (approximately .00015 percent) of these taxpayers had a levy that we should have stopped. The other 22 taxpayers' levies were activated before they had filed a claim. We revised our Internal Revenue Manual (IRM) procedures to ensure employees release levies and refund the money to the taxpayer. Not only do we prohibit collection activities, such as levies, seizures, and judicial proceedings, we also made a policy decision not to offset a taxpayer's refund while a claim is pending. We are refunding the levy payments to the 3 affected taxpayers.

## **Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed**

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You identified some claims that did not meet basic qualifications for innocent spouse relief that still had freezes on their accounts. Although this causes little or no burden to the taxpayer, it does prevent collection activity from resuming. We removed the freezes from the 32 accounts you identified. We agree that the potential exists for additional revenue up to \$219,000 from the 32 accounts you identified. However, the amount realized may be much lower. In the future, we will automate removal of such freezes.

You also reported 610 accounts that we should have frozen. This represents only 1.6 percent of the 37,167 claims filed. Management is now aware of their responsibility to review unpostable listings weekly, so we expect this statistic to improve. In addition, although there were 1,200 instances where the freeze or the removal of a freeze was not posted to a taxpayer's account due to an unpostable condition, IRS corrected these accounts prior to your review.

Notwithstanding significant improvement in our case processing timeliness, we agree that the time required to process 383 claims (or approximately 1 percent of the 37,167 claims you reviewed) exceeded 6 months, after which taxpayers may petition the Tax Court. However, our Chief Counsel advised that only a handful of taxpayers have filed petitions for this reason.

Our comments on your recommendations are attached.

If you have any questions or need additional information regarding this response, please contact Jim Grimes, Director, Reporting Compliance, at (404) 338-7643.

Attachment

## **Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed**

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Attachment

### **RECOMMENDATION #1**

The Commissioner, Wage and Investment Division, should ensure freezes are in place or removed as appropriate for those claims received prior to and subsequent to our data analysis until a formal process is developed (see Recommendation #2) to ensure taxpayer rights and the government's interest in taxes owed is protected.

### **CORRECTIVE ACTION**

We will review the cases to ensure the freezes are in place or removed as appropriate.

### **IMPLEMENTATION DATE**

September 30, 2003

### **RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, Wage and Investment Division

### **CORRECTIVE ACTION MONITORING PLAN**

The Director, Reporting Compliance, Wage and Investment Division will follow up with the Innocent Spouse Operations manager in CCISO to verify the freezes were input or removed as required.

### **RECOMMENDATION #2**

The Commissioner, Wage and Investment Division, should develop a process to ensure collection actions are halted and freezes are removed from accounts as required. Incorporated in this process should be procedures to obtain and use the unpostable reports until a better process is developed to address the unpostable conditions.

### **CORRECTIVE ACTION(S)**

Wage and Investment Compliance has implemented several actions to ensure collection actions are halted and freezes are removed from accounts as required. In the first quarter of Fiscal Year (FY) 2003, we issued procedures for processing claims when a levy is involved. We also revised IRM 25.15 to inform employees about freeze requirements. We required our managers to retrieve and resolve weekly the electronic unpostable listing. In the second quarter of FY 2003, we initiated a Request for Information Services placeholder for systemic changes to the Automated Collection System to prevent levy action from occurring on a petitioning spouse. We also issued a joint memo with Field Assistance to ensure new claims received in the field are expeditiously forwarded to CCISO.

ICP Phase IV will systemically remove freezes when we close cases.

### **IMPLEMENTATION DATE**

January 31, 2005

## **Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed**

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**RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

The Director, Reporting Compliance, Wage and Investment Division will follow up with the Innocent Spouse analyst to ensure ICP Phase IV is implemented timely and the revised IRM is published and distributed. The Director will also follow up with the Innocent Spouse Operations Manager to ensure managers are working the unpostable listings.

**RECOMMENDATION #3**

The Commissioner, Wage and Investment Division, should ensure claim origination information is transferred from the ICP to the Innocent Spouse Tracking System (ISTS) and that the claim origination field requires a mandatory entry, thereby eliminating default to the Centralized Site as the claim origination.

**CORRECTIVE ACTION**

The ICP programmer, ISTS programmer, and the Innocent Spouse analyst corrected programs to accurately transfer claim origin information from ICP to ISTS.

**IMPLEMENTATION DATE**

Completed April 25, 2003

**RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**RECOMMENDATION #4**

The Commissioner, Wage and Investment Division, should revise Form 8857 to include a reminder to send claims directly to the Centralized Site for those taxpayers who are not working with an IRS employee in Examination, Appeals, or Collection, or who have not received a Notice of Deficiency.

**CORRECTIVE ACTION(S)**

We established a P.O. Box number where all innocent spouse claims should be mailed. We are requesting changes to Form 8857 to include the P.O. Box number and instructions advising the taxpayer to mail the completed form to that address.

We issued a memo on October 2, 2002, advising field employees to expedite the routing of Form 8857 to CCISO.

## **Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed**

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**IMPLEMENTATION DATE**

January 31, 2004

**RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

The Director, Reporting Compliance, Wage and Investment Division will follow up with the Innocent Spouse analyst to ensure the revision to Form 8857 is completed.

**RECOMMENDATION #5**

The Commissioner, Wage and Investment Division, should develop a process to enable management to monitor claims from IRS receipt until a determination is completed.

**CORRECTIVE ACTION**

We will design new management inventory reports on ICP readily identifying claims that stay in a particular stage longer than the recommended time.

**IMPLEMENTATION DATE**

January 31, 2005

**RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

The Director, Reporting Compliance, Wage and Investment Division will mandate a quarterly review of inventory reports.

**RECOMMENDATION #6**

The Commissioner, Wage and Investment Division, should develop internal guidelines to specifically address those claims where a freeze is not required.

**CORRECTIVE ACTION**

We revised IRM 25.15 2.4.2 to specifically list when a Transaction Code 971 (which generates the collection freeze) is not applicable.

**IMPLEMENTATION DATE**

September 30, 2003 (IRM projected distribution date)

**RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, Wage and Investment Division

## **Improvements Are Needed to Ensure Innocent Spouse Claims Are Accurately and Timely Processed**

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### **CORRECTIVE ACTION MONITORING PLAN**

The Director, Reporting Compliance, Wage and Investment Division will ensure the IRM is distributed.

### **RECOMMENDATION #7**

The Commissioner, Wage and Investment Division, should develop a timeliness benchmark for those claims received in the field.

### **CORRECTIVE ACTION**

We do not agree that a timeliness benchmark for claims received in the field is warranted. Other actions we are taking should significantly decrease the number of claims received in the field.

### **IMPLEMENTATION DATE**

N/A

### **RESPONSIBLE OFFICIAL**

N/A

### **CORRECTIVE ACTION MONITORING PLAN**

N/A